

ORIGINAL

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

JUN - 7 1993

In the Matter of

Amendments of Parts 32, 36, 61,
64 and 69 of the Commission's
Rules to Establish and Implement
Regulatory Procedures for Video
Dial Tone Service

Petition for Rulemaking

RM 8221

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

REPLY OF BELL ATLANTIC¹

The few commenters who support the cable incumbents' rulemaking petition merely repeat arguments that the Commission has already rejected² or mischaracterize the video dialtone applications now pending before the Commission.³ These commenters offer nothing new, and their claims have previously been refuted.⁴

Moreover, these commenters fail to address the harm that delaying video dialtone would cause. As Congress and the

¹ The Bell Atlantic telephone companies ("Bell Atlantic") are The Bell Telephone Company of Pennsylvania, the four Chesapeake and Potomac telephone companies, The Diamond State Telephone Company and New Jersey Bell Telephone Company.

² See, e.g., Comments of NARUC at 1-2 ("reiterat[ing]" arguments rejected in video dialtone proceedings).

³ See, e.g., Comments of New Jersey Cable TV Ass'n at 5-10 (mischaracterizing New Jersey Bell applications).

⁴ See Opposition of Bell Atlantic (filed May 21, 1993); see also Opposition of New Jersey Bell to Petitions to Deny, W-P-C-6840 (filed Feb. 4, 1993).

No. of Copies rec'd
List A B C D E

249

Commission both have found, cable exercises market power to the detriment of consumers,⁵ and the best solution to this problem is new facilities-based competition.⁶ Consequently, the Commission's "overarching goals" for video dialtone are to promote an "advanced telecommunications infrastructure, increas[e] competition in the video marketplace, and enhanc[e] the diversity of video services to the American public."⁷ These goals will not be achieved if cable and its allies succeed in their quest to delay video dialtone indefinitely.

Finally, the petitioners and their supporters base their arguments on a world that does not exist. The monopoly cable industry claims that telephone companies will drive the entrenched incumbents from the field, while other commenters claim telephone companies might in doing so shift video dialtone costs to, and increase rates for, basic telephone services.

⁵ See Cable Television Consumer Protection and Competition Act of 1992, § 2(a)(2) (most cable systems "face[] no local competition;" [t]he result is undue market power for the cable operator as compared to that of consumers...."); Rate Regulation Order at 8 (since 1984, "cable systems continued to develop without direct multichannel video competitors....[and] consumers were left without the protections...they would have had in a competitive environment").

⁶ See H. Conf. Rep. No. 862, 102d Cong., 2d Sess. at 93 (1992) (directing the Commission to adopt rules to "encourage arrangements which promote the development of new technologies providing facilities-based competition to cable...."); Program Access Order at 26, n.79 ("The focus of the 1992 Cable Act is on assuring that facilities-based competition develops.").

⁷ Telephone Company-Cable TV Cross-Ownership Rules, 7 FCC Rcd 5781, 5783 (1992).

These claims are based on assumptions that are not realistic in today's world.

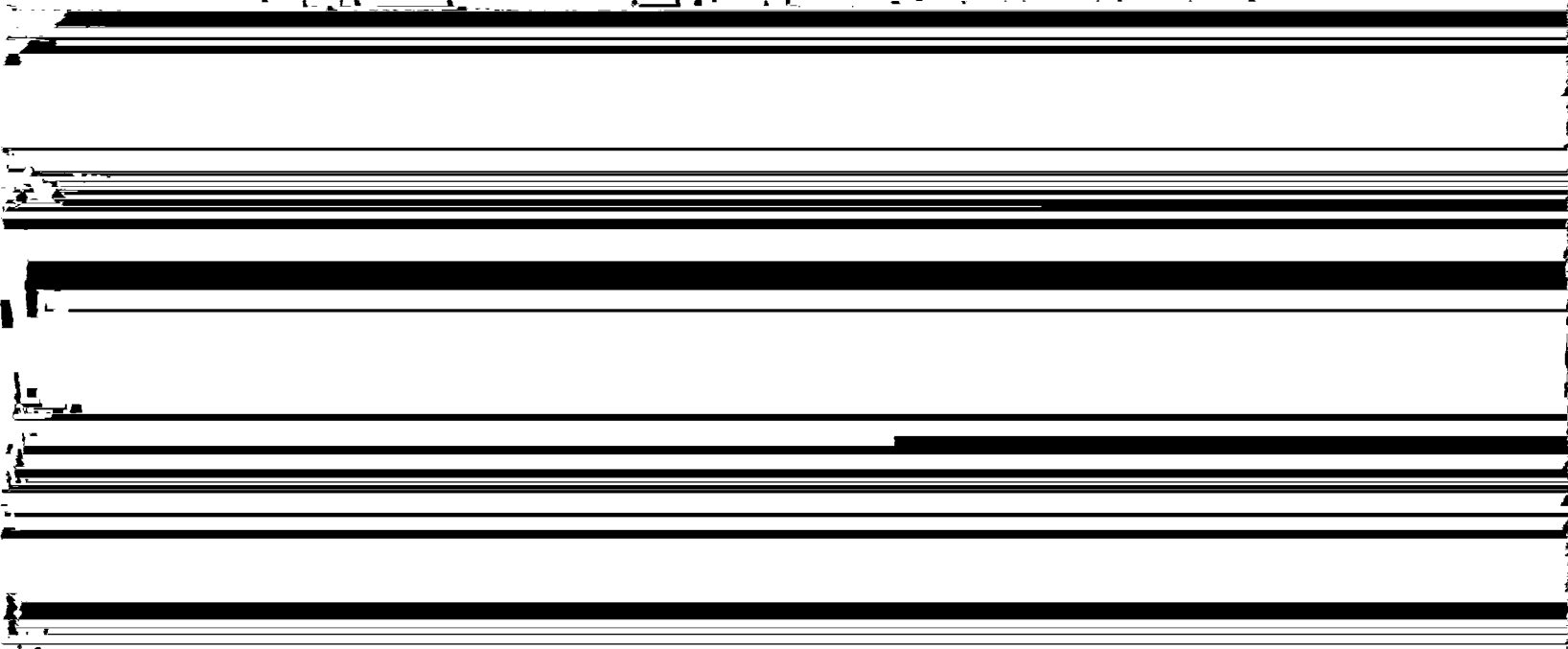
For example, these claims assume that existing rules enable telephone companies to cross subsidize their video dialtone services. As Bell Atlantic and others have shown,⁸ this assumption is flawed. All three federal agencies responsible for telecommunications policy agree.⁹

In addition, these claims also assume that telephone companies could, in the absence of regulatory oversight, cross subsidize their video dialtone services and drive the cable incumbents from the market. As Professor Alfred Kahn recently explained, however, it is highly unlikely that telephone companies would be able to cross subsidize their video transmission services even if permitted by regulators to do so. Kahn Aff. ¶¶ 8-17.¹⁰ This is true for several reasons.

is promoting this competition. Id., ¶¶ 9-10.¹¹ Even absent regulatory constraints, therefore, telephone companies are to an increasing degree competitively constrained from imposing price hikes that would be needed to recover losses on other services.

Second, telephone companies are subject to price caps at the federal level and incentive regulation plans in a majority of the states. Id., ¶¶ 11-13. These plans further weaken any incentive or ability telephone companies might otherwise have to cross subsidize competitive services since doing so will merely decrease overall profits. Id. at ¶ 13.


Third, the notion that telephone companies could kill off the entrenched cable monopolists is fanciful. Cable has facilities in place that can serve 96 percent of U.S. households, and that are not going to go away. Id., ¶ 17. Cable operators, moreover, have relatively low incremental costs, enabling them to drop their prices to withstand any attempt at predation. Id. Thus, it is inconceivable that cable could be driven out of the



In short, the petitioners and their supporters are wrong not just about the adequacy of the Commission's existing rules, but also about the degree to which those rules are needed in the first place.

Respectfully submitted,

Edward D. Young, III
John Thorne
Of Counsel


Michael E. Glover
1710 H Street, N.W.
Washington, D.C. 20006
(202) 392-1082

Attorney for the Bell Atlantic
Telephone Companies

June 7, 1993

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
(Alexandria Division)

THE CHESAPEAKE AND POTOMAC
TELEPHONE COMPANY
OF VIRGINIA, *et al.*,

Plaintiffs,

v.

UNITED STATES OF AMERICA,
et al.,

Defendants

Civil Action No. 92-1751-A

REPLY AFFIDAVIT OF ALFRED E. KAHN

STATE OF NEW YORK

COUNTY OF TOMPKINS

(1) My name is Alfred E. Kahn. I am Robert Julius Thorne Professor of Political Economy, Emeritus, at Cornell University and Special Consultant to National Economic Research Associates, Inc. My business address is 308 North Cayuga Street, Ithaca, New York 14850.

(2) Among the experiences of mine pertinent to my submission in this proceeding are that I was Chairman of the New York State Public Service Commission between 1974 and 1977 and of the Civil Aeronautics Board in 1977-78; I am the author of the two-volume The Economics of Regulation, published originally by John Wiley & Sons in 1970 and 1971 and reprinted in 1988 by The MIT Press; I have written and testified extensively on the subject of telecommunications regulatory policy and published a book and numerous articles on antitrust policy. I was a member of the Attorney General's National Committee to Study the Antitrust Laws and the National Commission for the Review of Antitrust Laws and Procedures. I have been advisor on telecommunications policy to Governor Carey, of New York State, recently completed service as a member of the Ohio Blue Ribbon Panel on Telecommunications Regulatory Reform, and am at

present a member of the New York State Telecommunications Exchange. I attach a copy of my full résumé as an Appendix to this affidavit.

(3) The purpose of my affidavit is to appraise and respond to the government's proffered justification for the ban against the plaintiffs providing their video programming to the public within their telephone service areas--namely, that the prohibition is necessary to prevent the telephone companies from "cross-subsidizing" cable operations with revenues from their monopoly telephone operations. The result of such a cross-subsidy, the government contends, would be that the cable companies could or would be driven out of business, leaving the telephone company as the monopoly provider of both cable and telephone services.

(4) This contention of the government of the likely--or even possible--effects of a lifting of the ban rests on a number of key premises. The most important of these are that authorization of the telephone companies or their affiliates to create or assemble video programming for sale to the public, in addition to their present ability to carry the signals of others, would materially increase the asserted danger of cross-subsidization; that regulators would freely permit the recoupment from politically-sensitive services such as basic local residential service, of costs that could or should have been assigned to video; and that the telephone companies would, as a result, be able to drive their cable competitors from the market. All of these beliefs are in my opinion erroneous.

(5) The asserted danger of cross-subsidization, as described by both the Department of Justice and the NCTA, arises almost exclusively from the fact that the telephone network is evolving into a facility capable of carrying voice, data and video images. Cable systems too are developing these same capabilities. This kind of joint or common use is not an evil in itself: on the contrary, it is a source of efficiency--a clear exemplification of what economists refer to as economies of scope. It does increase the importance of the issue, particularly in a regulated industry, of how the common costs are to be distributed among those several services. This is not a new regulatory problem in telephony: regulators have long ago developed methods of separating the costs of telephone service subject respectively to state and to federal regulation. They have also devised

and prescribed methods of assigning or allocating joint and common costs among the various individual services subject to their respective jurisdictions. Intervenor has the right to contest these methods in regulatory proceedings and rights of appeal if they are not satisfied with the agency's determinations.

(6) As the foregoing discussion makes clear, the danger of cross-subsidization typically arises in situations in which significant portions of the costs of competitive and monopoly services are common to both. If some of these costs are improperly shifted from the former to the latter and recovered in the charges for the monopoly services, this could indeed confer an unfair advantage on the telephone company in its competitive markets, and could conceivably enable it to drive its competitors out of business. The question is whether this hypothetical scenario fits the facts and the probabilities associated with the legal issue now before this Court. I conclude emphatically that it does not.

(7) First, it cannot be overemphasized that what is at issue in this case is the plaintiffs' authority to engage in video programming, not their already acknowledged authority to provide video transmission. It is difficult to conceive that there could be any substantial costs common to the transmission of video and other telephone signals, on the one side, and the creation and packaging of video programming on the other. Numerous authorities, including the defendants, have actually conceded this fact. For example, NCTA, through economist Dr. Owen, admits that the defendants' cross-subsidy scenario requires the presence of common costs¹ and that there are no substantial costs common to both video transport and programming.² And the Department of Justice has conceded elsewhere that "information services that involve primarily the provision of content or the processing of information...would be likely to share fewer facilities or personnel with

¹ E.g., Owen Aff. at 15.

² E.g., Owen Aff. at 4 ("there are no obvious economies of scope or of vertical integration arising from both laying fiber optic cable and producing or buying and then packaging video programming"); see also NCTA Mem. at 23, United States v. Western Elec. Co. (D.D.C. filed Oct. 17, 1990), ("it may well be, as the Huber Report says, that opportunities for cross-subsidization may be few in the creation of programming").

[telephone company] local exchange operations [than transmission services]....[T]he potential for misallocation of costs in violation of allocation regulations is minimal and even more easily detected by regulators where there is a relative paucity of joint and common costs between telephone exchange operations and ventures in the new market."³ The statutory ban at issue here applies not to a service that, in the words of the Department, involves "primarily the... content of information"; it applies to a service that involves only content. There is therefore no rational connection between the defendants' cross-subsidy argument and the ban against telephone companies providing video programming.

(8) In the interest of a complete response, however, I have considered whether, if the prohibition at issue here is lifted, the telephone companies might, as Dr. Owen contends, be in a position somehow to cross-subsidize their video transmission services at the expense of other, monopoly services. In my view this is highly unlikely--unlikely that they would be permitted, and even if permitted, able to do so. As for the first, I am advised by counsel that video transmission services are subject to federal, not state regulation. The principal other services subject to that jurisdiction are the "access" to or interconnection with the local exchange network that telephone companies provide to long distance carriers such as AT&T for the origination and termination of long distance calls. The FCC's method of regulating these charges does not automatically permit raising them whenever the providers' overall earnings decline; and its cost allocation rules, to which I have already referred, prohibit that kind of cross-subsidization.

(9) As to the ability of the telephone companies to raise their rates for these access services, these charges constitute approximately 40% of the long distance carriers' total operating costs. Entirely apart, then, from whether the FCC would permit the requisite increase, the resistance on the part of the customers would be intense, and effective. These are very sophisticated carriers, with every incentive to avoid improper cost shifting to their injury. And they have the protection, increasingly, of competition, and will have it even more in the future, as alternative providers of

³ Mem. of the United States at 34, United States v. Western Electric Co., Inc., (D.D.C. filed Aug. 22, 1990).

access services have emerged to handle the origination and termination of long-distance traffic, particularly of large governmental and business installations. The recently announced multi-billion dollar Time Warner/US West transaction is premised on the fact that cable systems, which now reach 96 percent of all households, can be modified to provide this same access service, in competition with local telephone companies, for small as well as large customers. MCI, similarly, has announced its engagement in active negotiations with cable companies, with the same purpose in mind. For these many reasons I conclude that there is no significant danger of successful cross-subsidization even of video transmission by telephone services--whether or not the telephone companies are permitted to engage in video programming.

(10) Recovery of any such subsidies at the intrastate or local level is similarly highly unlikely, and becoming increasingly so every day. Entirely apart from the question of the willingness of state regulators to permit it, local service is becoming increasingly competitive. NCTA itself describes the cable industry as a "serious source of potential competition for residential telephone service."⁴ Furthermore, the divestiture of AT&T has spawned a host of actual and potential competitors previously all part of that single corporate entity. Southwestern Bell, for example, has acquired cable systems in the Washington area, including Northern Virginia, which position it to provide not just video but competitive access services of the type contemplated also by the U.S. West/Time Warner transaction. Southwestern Bell also provides wireless services in this area. AT&T has already purchased a multi-billion dollar stake in wireless services competitive or potentially competitive with the incumbent local telephone companies; and the trade journals report that MCI likewise intends to enter the local exchange business with wireless technology. The FCC is actively promoting expansion of this competition--for example, by allocating additional spectrum to new wireless services and requiring the telephone companies to provide interconnection with all competitive access providers.

⁴ Owen Aff. at 31.

(11) At least equally important, state regulators have historically been very reluctant to raise residential telephone rates, for obvious political reasons. Consequently, even if the costs of video programming could be misassigned to transmission services, and misassigned again over the federal-state jurisdictional boundary to local exchange services, it is certain that the regulators would resist the requisite compensatory price increases. If the state regulatory commissions may be said to have had one overriding goal historically, it has been to hold down the price of basic residential telephone service; and they have done so to the point of holding those prices inefficiently low and requiring inefficiently high charges for "vertical" or "enhanced" services. Far from permitting cross-subsidization of competitive by monopoly services, regulators have typically handicapped telephone companies in the competitive markets--inefficiently so.

(12) As the defendants themselves point out,⁵ the cross-subsidization they predict is possible only to the extent a telephone company's services are subject to cost-based, rate-of-return regulation. The kind of recoupment they posit was never automatic, even under that traditional regulatory practice: rates were altered only periodically and raised only when achieved rates of return fell outside an acceptable range.

(13) In both 1970, when the FCC first adopted the prohibition at issue here, and 1984, when Congress enacted it, telephone companies were in fact universally subject to traditional rate-of-return regulation. Today, in contrast, the FCC and a majority of state regulators have substantially modified that form of regulation in favor of price freezes or caps, which fix the price of services rather than telephone company profits, or other "incentive" regulatory arrangements that permit company profits to fluctuate within a wider than traditionally permitted range, with or without automatic sharing with ratepayers of profit surpluses or deficiencies. All of these plans, by further weakening any previous assurances of automatic recovery from less competitive services of net revenue losses from competitive ones, have the effect of weakening any incentive or ability the telephone companies may previously have had to cross-subsidize competitive services at the expense

⁵ E.g., Owens Aff. at 15.

of others less subject to competition. Indeed, prevention of cross-subsidy has been one central, explicit reason for the adoption of these reforms. The very fact that it is the telephone companies themselves that have been the principal proponents of these plans further contradicts the defendants' contentions that they would respond to removal of prohibitions on their entering various competitive businesses with a strategy of cross-subsidy. Under the various forms of incentive regulation, the incurrence of "losses" on competitive business would simply decrease their profits. Significantly, even NCTA concedes that a pure price cap arrangement would "reduce or eliminate the incentive to shift costs to regulated services."⁶

(14) There are some respects in which the arguments of the defendants do not rest entirely on the presence of common costs, on the one side, and of the opportunity to recover the burdens of cross-subsidy via cost-plus regulation on the other. For example, one of the amici on the side of the cable industry argues that the telephone companies would have an unfair advantage by virtue of their ability to "cherry pick personnel" from their telephone operations for the benefit of their video programming services.⁷ But, as the DC Circuit has observed with admirable conciseness, "[r]unning a local [telephone] exchange does not require reporters, copy editors, joke writers, financial analysts, astrologists, or other information-content providers"⁸--to which list one might add screen writers, Hollywood stars and game show hosts.

(15) Dr. Owen's affidavit on behalf of NCTA also cites, as an asserted unfair advantage of telephone companies, their ability to raise capital for the combined enterprise on more favorable terms than their cable competitors. First of all, the opinion he expresses that the overall cost of capital of well-managed cable companies is higher than of telephone companies is a mere undocumented assertion on his part. In any event, the sufficient response is that nowhere in the economist's conception of the prerequisites of effective competition or in the antitrust laws, to my

⁶ Owen Aff. at 23.

⁷ Brief of Amici Curiae Consumer Federation of America, et. al., at 22 (dated May 21, 1993).

⁸ United States v. Western Electric Co., 900F. 2d 283, 308 n. 28 (D.C. Cir. 1990).

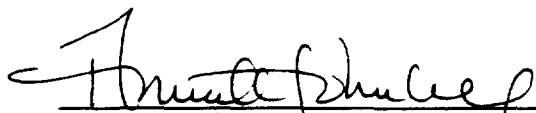
knowledge, has the mere possible ability of one company to raise capital on more favorable terms than another been regarded as providing a sufficient basis for excluding that company from the opportunity to compete with others putatively less advantageously situated in that respect.

(16) Finally, Dr. Owen's asserted concern that a telephone company could engage in "self dealing" by paying a programming affiliate inflated prices for its programming has the facts completely backwards. It is not the telephone company that proposes here to purchase programming


Alfred E. Kahn

Subscribed and sworn to before me

this 28th day of May 1993


Notary Public

My Commission Expires 12/31/93

ANNA K. HOLMBERG
Notary Public, State of New York
Qualified in Tompkins Co. No. 46970202
My Commission Expires Dec 31 1993

EXCERPTS FROM PRINCIPAL GOVERNMENT DOCUMENTS

A. Federal Communications Commission

1. Telephone Company-Cable Television Cross-Ownership Rules, 7 FCC Rcd 5781 (1992).

-- The FCC's Order authorizing telephone companies to provide video dialtone states: "We conclude that existing safeguards against discrimination and cross-subsidization in the provision of basic services by the local telephone companies ... should effectively protect against potential anticompetitive conduct by local telephone companies providing video dialtone." Id. at 5827.

-- "We further conclude that our existing safeguards with respect to nonregulated services are sufficient at this time to protect against cross-subsidization.... [T]he Commission presently has in place a comprehensive system of cost allocation rules and cost accounting safeguards designed to separate non-regulated service costs from regulated service costs. In addition, we have recently strengthened these cost accounting safeguards in order to ensure that the Commission is able to prevent and detect abuses should they occur. To the extent that a local telephone company provides nonregulated services as part of video dialtone, these safeguards will apply fully...." Id. at 5828-29 (citations omitted).

-- "As for the provision of enhanced services by local telephone companies, we note that in addition to the above accounting safeguards designed to prevent cross-

industry.... Given this widely changed competitive situation, we find it reasonable to conclude that, with appropriate safeguards on their entry, there is little threat that the local telephone companies could preemptively eliminate competition and monopolize the market for video programming services." Id. at 5848-49.

2. The Chesapeake and Potomac Telephone Company of Virginia, W-P-C-6834, Order and Authorization (rel. Mar. 25, 1993).

-- The FCC's Order authorizing C&P to provide video dialtone service states: "[W]e believe that our existing safeguards, in conjunction with the requirement that C&P offer non-discriminatory access to the basic platform, are adequate to protect against anticompetitive conduct by C&P. Among these safeguards are the cost allocation rules and cost accounting safeguards designed to separate nonregulated service costs from regulated service costs ... our ONA policy, which we believe constitutes an effective safeguard to ensure that independent enhanced service providers are able to obtain non-discriminatory access to basic services, and our non-discrimination reporting requirements, and network disclosure rules.... We are not persuaded, nor has it been shown by commenters, that these safeguards are inadequate to protect against cross-subsidization and discrimination by C&P." Id. at 9-10.

3. Reply Memorandum of FCC, United States v. Western Electric Co., Inc., C.A. No. 82-0192 (D.D.C. filed Jan. 18, 1991).

-- The FCC's brief urging removal of the information services restriction states: "The Department [of Justice] has concluded that, because of regulatory constraints, 'it is unlikely that any significant cross-subsidization would occur and go undetected even where [telephone company] information services share facilities and personnel with regulated telephone services....' As the Department cogently points out, moreover, information services that involve primarily the content or the processing of information rather than transmission ... would be likely to share fewer facilities and personnel with regulated telephone service.... The potential for an undetected misallocation of costs is reduced when there are fewer joint and common costs." Id. at 41 (citations omitted).

-- "[T]he Commission's decision to implement 'price cap' regulation ... will complement its regulatory safeguards by displacing the traditional ratemaking

incentives to shift costs from nonregulated activities to monopoly services.... Under price cap regulation, the [telephone companies] no longer are able ... to recover in their rates for regulated services any increased costs they have allocated to those services. Under price cap regulation, any misallocation of costs to regulated services, even if undetected, generally would not enable a [telephone company] simply to raise its rates for such services to cover the misallocated costs and thus to recoup revenues to subsidize its nonregulated services." Id. at 43-44 (citations omitted).

4. Brief of FCC as Amicus Curiae, United States v. Western Electric Co., No. 91-5263 (D.C. Cir. filed Aug. 31, 1992).

-- On appeal, the FCC reiterated that: "[R]egulatory safeguards are adequate to minimize the possibility of unfair competition by the [telephone companies] as they enter [information] services. More importantly in the context of this remanded proceeding, the Justice Department shares the Commission's belief and told the district court

The Commission relies in particular on its Computer

of price cap regulation for the LECs [local exchange carriers] constitutes an effective complement to cost allocation, reporting, and enforcement safeguards, to reduce ... incentives to cross-subsidize." Id. at 7577-78.

6. Testimony and Summary of Statement of Alfred C. Sikes Before the House Subcommittee on Economic and Commercial Law (Mar. 18, 1992).

-- Then FCC Chairman Sikes testified: "Over the past five years, new regulatory approaches have also been instituted which go far toward reducing the possibility of discriminatory conduct or anticompetitive cross-subsidization.... Price caps reduce the likelihood of anticompetitive cost-shifting.... It should be noted, moreover, that some 36 State jurisdictions -- including most of the largest States -- have adopted their own system of incentives-based regulation." Id. at 9-10.

-- "Whatever might have been possible prior to the break-up of the unified Bell System, or before we instituted a comprehensive package of regulatory safeguards, the reality today is that the FCC does have effective tools, and has clearly demonstrated both the willingness and ability to use them." Id. at 10.

-- The accompanying summary states: "[s]ince 1987, the FCC has instituted an array of new regulatory safeguards ... which make anticompetitive cost-shifting infeasible."

7. Transcript of Hearings Before the Subcommittee on Communications on S.1200 (Feb. 28, 1992).

-- Chairman Sikes testified: "[W]e have ... worked hard to facilitate competition to local exchange carriers, and at present they are competitively engaged in respect to many of the high-volume customers. Now, when you are facing competition, you simply cannot do that kind of cost shifting. For the most part, these competitive access providers probably have lower cost structures to begin with, and the thought that ... local exchange carriers can kind of rightfully shift costs of new ventures in and still be competitive is just nonsense." Id. at 102.

8. Telephone Company-Cable Television Cross-Ownership Rules, 3 FCC Rcd 5849 (1988).

-- In this notice relied on by the government here, the FCC concluded that the "ban is presumptively

unnecessary" because less restrictive "nonstructural safeguards are available." Id. at 5854. "[W]hile telephone companies continue to have the ability to ... engage in anticompetitive cross subsidies, safeguards perhaps analogous to those devised in Computer III would avoid the costs to consumers caused by a ban and ... even if such safeguards need to be supplemented by additional protective measures, those measures could be applied in an individual Section 214 proceeding." Id. at 5860.

B. The Department of Justice

1. Reply Comments of the United States Department of Justice, Telephone Company-Cable Television Cross-Ownership Rules, CC Dkt 87-266 (Mar. 13, 1992).

-- The Department's brief urging repeal of the video programming ban states: "In connection with potential discriminatory conduct aimed at other information and video gateway service providers, the Department believes that video dialtone does not require safeguards other than the equal access requirement and other requirements that are generally applicable to enhanced services. Some information service providers will be able to reach consumers through cable company facilities as well as through LECs' video dialtone facilities. Thus, the LECs will be unable to discriminate against these providers in any meaningful way. With respect to other information service providers who will be dependent on the LECs' video dialtone facilities ... as the Department stated to the MFJ court in supporting [Bell telephone company] entry into provision of information services, the existing safeguards combined with the overall difficulty of targeting discrimination against particular information service providers are likely to prevent serious anticompetitive abuses by the LECs." Id. at 18-19 (footnote omitted).

-- "The Department similarly does not believe that additional safeguards are needed to prevent LECs from cross-subsidizing competitive elements of video dialtone by misallocating the costs involved to their regulated local telephone services. Again, for the same reasons the Department stated to the MFJ court in supporting ... entry into provision of information services, cross subsidization in this area is not likely to succeed in lessening competition, and price reductions are more likely to reflect greater competition than predation." Id. at 19.

-- "Thus, the Department disagrees with those commentators who argue that the Computer III rules are

inadequate to protect against anticompetitive conduct in
connection with LEC provision of information services ...
and therefore, will be inadequate to protect against

-- "There is no substantial risk that competition would be impaired by ... cross-subsidization.... Because of regulatory constraints, it is unlikely that any significant cross-subsidization would occur and go undetected even where ... information services share facilities and personnel with regulated telephone services. Since 1987, the FCC has implemented its Joint Cost rules and improved its auditing procedures. The Joint Cost rules ... govern the allocation of costs between regulated and unregulated ... activities." Id. at 33-34.

-- "Moreover, information services that involve primarily the provision of content or the processing of information rather than transmission would be likely to share fewer facilities or personnel with ... local exchange operations than the gateway services the Court already has authorized.... [T]he potential for misallocation of costs in violation of allocation regulations is minimal and even more easily detected by regulators where there is a relative paucity of joint and common costs between exchange operations and ventures in the new market. Thus, allowing

difficult, if not impossible, however, for a [telephone company] to target discrimination precisely." Id. at 4-5.

-- "Finally, there is no merit to objectors' contentions that the [telephone companies] would lessen information services competition by cross-subsidization, predation or strategic entry deterrence. Regulation by the Federal Communications Commission and the states constrains misallocation of information services costs to regulated exchange services." Id. at 6.

4. Brief of Appellee United States of America, United States v. Western Electric Co., No. 91-5263 (D.C. Cir. filed Oct. 5, 1992).

-- The Department reiterated its views on appeal: "The United States also explained why it had concluded that there would not be a significant risk of anticompetitive conduct if the information services restriction were removed. Regulation provides one important constraint. By 1991 the FCC had implemented additional safeguards against discrimination and misallocation of costs that were not in effect in 1982 or 1987." Id. at 25.

-- "In sum, the United States' analysis of the competitive risks of removing the decree restriction and allowing the [Bell telephone companies] to provide information services took into account the combined effects of regulation, the variety of telephonic and nontelephonic alternatives to many information services, and the practical difficulties of targeting discrimination.... The United States also explained that regulation would constrain misallocation of costs of ... information services to regulated exchange services and that even if misallocations did occur they would not be likely to result in anti-competitive predation or increased information services prices." Id. at 28-29 (emphasis in original).

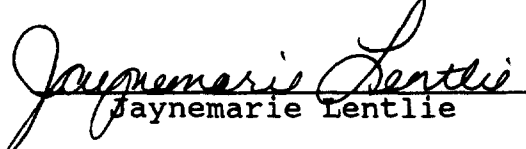
5. Statement of James F. Rill Before the House Subcommittee on Economic and Commercial Law at 16-17 (Mar. 18, 1992).

-- Then Assistant Attorney General Rill testified: "The prophylactic concept of information services restrictions has lost its relevance.... The concern that the [Bell telephone companies] could restrict access to their networks was removed by the combined effect of the FCC's new Computer III/ONA regulatory standards, and the obvious difficulty of effectively targeting discrimination without detection.... As the Department explained to the court in the information services remand proceedings, the costs of such discrimi-

nation ... would be substantial, and the benefits uncertain.
If there had been no guidance in the 1960s case of anti-

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing "Reply of Bell Atlantic" was served this 7th day of June, 1993, by delivery thereof by first class mail, postage prepaid, to the parties on the attached list.


Jaynemie Lentie

Martin T. McCue
Linda Kent
USTA
900 19th Street, N.W. Ste. 800
Washington, D.C. 20006-2105

John S. Seiver
Cole, Raywid & Braverman
1919 Pennsylvania Ave., N.W.
Second Floor
Washington, D.C. 20006-3458

Alan J. Gardner
Carrington F. Phillip
California Cable Television
Association
4341 Piedmont Avenue
Oakland, CA 94611

David Cosson
L. Marie Guillory
NTCA
2626 Pennsylvania Ave., N.W.
Washington, D.C. 20037

David R. Conn
Iowa Office of Consumer Advocate
Lucas State Office Building
Des Moines, IA 50319

Paul Rodgers
Charles D. Gray
James Bradford Ramsay
NARUC
1102 ICC Building
P.O. Box 684
Washington, D.C. 20044

Gene Kimmelman
Consumer Federation of America
1424 16th Street, N.W.
Suite 604
Washington, D.C. 20036

Daniel L. Brenner
David L. Nicoll
NCTA
1724 Massachusetts Ave., N.W.
Washington, D.C. 20036